Business In Nebraska

September 1990
Vol. 46 No. 552

Prepared by the Bureau of Business Research
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University of Nebraska-Lincoln
Lincoln, NE 68588-0406
402/472-2334

The 2 Percent Lid: Part I

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Introduction

In the November general election, Nebraska voters will have an opportunity to vote on Ed Jaksha's petition-initiated amendment to the state constitution that would place a 2 percent lid on government spending in Nebraska.

If passed, Nebraska's state and local governments could be required to function under an extremely restrictive budget and expenditure limitation formula.

This is the first of a two part series on the economic implications of the proposed 2 percent lid. The focus of this first part is what other states have done to limit taxes and expenditures.

The second part, which will appear in the October *Business in Nebraska*, will look at the longer-term effects of the proposed 2 percent lid on local subdivisions of government. In the second article, representative budgets for a local school district, a county, and a municipality will be subjected to the 2 percent lid to show how the lid may affect local services.

The proposed 2 percent lid would prohibit Nebraska (the Unicameral) and local governments from increasing local and state tax dollar spending by more than 2 percent each year. The 2 percent lid proposal makes no allowance or adjustment for inflation and economic growth. Any increase above 2 percent in tax revenues would be returned to the taxpayers during the next fiscal year and could not be used otherwise by the state or by subdivisions of government.

The proposed 2 percent lid has a provision to increase expenditures at the state level if four-fifths of the members of the legislature (or 40 senators) approve or, at the local level, if a special election were held. One legal opinion on the interpretation of "local government" is that it includes all cities, towns, villages, counties, school districts, educational service units, technical community colleges, and special districts such as airport authorities, hospital districts, sanitary improvement districts, etc. Nebraska has over 3,000 subdivisions of local government.

Nebraska Follows Nation

As a result of the distressed economic climate of high inflation, soaring housing costs, record interest rates, tax bracket creep, and falling real incomes of the late 1970s, a ground swell of discontent with, and even distrust of, government emerged. The University of Michigan's biennial national election survey showed that in 1978 only 30 percent of the public said they trusted the government in Washington to "do what is right" all or most of the time, compared to 76 percent in 1964. In the same period, the proportion of the public regarding most government officials as competent fell from 69 percent to 41 percent.

The rise in political mistrust was an across-the-board phenomenon in all de-

State Economic Scoreboard

Change from same month one year ago.

	State	Metro+	Nonmetro
Motor Vehicle Sales (May) Constant $	-6.5%	-9.2%	-3.9%
Nonmotor Vehicle Sales (May) Constant $	1.4%	0.9%	1.9%
Building Activity (May) Constant $	7.7%	0.9%	17.3%
Employment (July)	6.3%	4.8%	7.9%
Unemployment Rate* (July)	2.2%	2.3%	2.2%

+Omaha and Lincoln. *Unemployment is this month's rate, not a percent change from year ago.

Table 1
State Tax Revenues as a Percent of State Personal Income

	1980	1981	1982	1983	1984	1985	1986	1987
States With Tax and Expenditure Limitations								
Arizona	6.71%	6.30%	6.24%	6.29%	6.86%	7.19%	7.12%	7.16%
California	7.01	6.64	6.65	6.32	6.58	6.86	6.81	7.26
Colorado	4.83	4.08	4.35	4.22	4.74	4.81	4.75	4.99
Hawaii	9.71	9.84	9.09	8.93	9.16	9.34	9.53	10.00
Idaho	6.03	5.99	6.37	6.34	6.63	6.75	6.65	7.00
Louisiana	6.53	6.64	6.97	6.52	6.42	7.61	7.18	6.74
Michigan	6.32	6.17	6.23	6.54	7.26	6.82	6.88	6.96
Missouri	4.58	4.21	4.31	4.62	4.88	5.02	5.11	5.26
Montana	6.18	5.92	6.52	6.03	6.53	7.04	6.44	5.91
Nevada	5.15	4.92	6.80	6.72	6.79	6.82	7.01	6.86
Oregon	5.58	5.77	5.49	5.94	5.73	5.84	5.40	5.84
Rhode Island	6.09	6.08	6.33	6.34	6.47	6.48	6.22	6.85
South Carolina	7.05	6.84	6.98	6.96	7.12	7.63	7.57	7.68
Tennessee	5.10	4.79	4.99	4.91	4.99	5.58	5.69	5.76
Texas	4.81	4.98	5.06	4.77	4.78	5.23	4.94	4.82
Washington	6.54	6.34	6.86	7.68	7.78	7.40	7.87	7.97
Subtotal	6.14%	5.93%	6.04%	5.94%	6.18%	6.41%	6.36%	6.55%
States Without Tax and Expenditure Limitations								
Alabama	6.17%	6.46%	6.30%	6.31%	6.70%	6.79%	6.55%	6.61%
Arkansas	6.78	6.20	6.36	6.32	6.61	7.03	6.99	6.87
Connecticut	4.88	4.93	5.17	5.22	5.73	6.05	6.15	6.38
Delaware	8.45	8.29	8.25	8.28	8.49	8.98	8.99	8.75
Florida	5.00	4.82	4.69	4.76	5.09	5.26	5.33	5.25
Georgia	5.95	5.82	5.88	5.72	5.74	6.00	5.99	5.98
Illinois	5.70	5.34	5.24	5.02	5.39	5.43	5.47	5.48
Indiana	5.31	5.06	5.43	5.41	6.22	6.34	6.17	6.20
Iowa	6.28	5.82	6.32	6.34	6.45	6.37	6.47	6.60
Kansas	5.39	5.20	5.07	5.31	5.63	5.66	5.36	5.57
Kentucky	7.30	6.99	7.27	7.36	7.22	7.50	7.66	7.83
Maine	6.68	6.59	6.70	6.62	7.12	7.26	7.31	7.78
Maryland	6.04	5.80	5.87	5.91	6.11	6.16	6.18	6.33
Massachusetts	6.44	6.39	6.56	6.49	6.62	6.97	7.45	7.55
Minnesota	7.79	7.44	7.96	8.63	9.09	8.82	7.75	8.20
Mississippi	7.18	7.15	7.11	7.17	7.51	7.50	7.56	7.19
Nebraska	5.59	4.77	4.89	5.49	5.40	4.99	5.16	5.27
New Hampshire	2.95	2.64	2.96	2.68	3.08	2.82	2.87	3.03
New Jersey	4.99	5.28	5.37	5.45	5.77	5.79	5.83	6.08
New Mexico	8.65	9.78	9.42	8.44	9.19	8.86	8.63	8.84
New York	6.75	6.65	6.91	6.74	7.14	7.38	7.60	7.69
North Carolina	6.81	6.48	6.78	6.63	6.83	7.12	7.09	7.30
North Dakota	6.64	6.72	7.52	7.15	8.63	8.48	7.30	6.56
Ohio	4.54	4.60	4.94	5.43	5.93	6.09	6.08	6.17
Oklahoma	6.21	6.73	7.39	7.10	6.85	7.42	7.31	6.50
Pennsylvania	6.16	5.88	6.02	5.93	6.34	6.31	6.29	6.27
South Dakota	4.75	4.64	4.98	4.79	4.78	4.55	4.83	4.67
Utah	6.70	6.48	6.74	6.49	7.28	7.56	7.47	7.53
Vermont	6.05	5.94	6.30	6.40	6.73	6.91	6.92	6.85
Virginia	5.20	5.11	5.07	5.13	5.32	5.42	5.42	5.67
West Virginia	7.89	7.59	8.31	8.21	9.06	9.49	9.11	8.75
Wisconsin	7.25	7.25	7.48	7.81	8.54	8.05	8.25	8.01
Wyoming	7.21	7.69	12.20	12.03	12.75	12.33	12.32	10.13
Subtotal	6.00%	5.88%	6.06%	6.06%	6.41%	6.51%	6.52%	6.57%
49 State Total	6.05%	5.90%	6.05%	6.01%	6.32%	6.47%	6.46%	6.56%

Source: National Association of State Budget Officers, *State Tax and Expenditure Limitations: There is No Story*, December 1988

mographic, partisan, and ideological subgroups of society. The discontent and distrust eventually were channeled into efforts to limit the power of state and local governments to tax and spend.

One of the most publicized movements was Proposition 13 (the Jarvis-Gann amendment) that was passed by California voters in June 1978 by a two-to-one margin. (California voters subsequently relaxed the limitation in June 1990, allowing increases in proportion to changes in personal income.)

Setting Limits on Government
State Limits

As early as 1983, 17 states had adopted some form of a tax or expenditure limit. Massachusetts and New Mexico adopted expenditure limitation measures in 1986 and 1987, respectively, bringing the total number of states with tax or expenditure limitation provisions to 19 by 1988.

For 12 of these 19 states, the tax and spending limitations placed on state government are tied to growth in state personal income. Most states use the variable formula method to control state government.

The variable formula method permits state and local governments to meet the increased demand for public services that generally accompanies growth in economic activity and/or population. Conversely, with the variable formula method, government expenditures contract if economic activity declines or if population drops within the area governed.

In contrast to the variable formula is the fixed number method. The fixed number method imposes an inflexible lid on government expenditures. The lid is independent of changes in demand for government services. The 2 percent lid proposed for Nebraska is a form of the fixed number method.

One great disadvantage of this method is that it inadvertently can limit a state's overall economic growth. In extreme instances, the fixed number method can trigger a localized recession. That unintended outcome is more likely to occur during times when the inflation rate exceeds the fixed formula rate or when an area is experiencing significant economic growth during a rapid gain in population.

Most states probably have chosen the variable formula method in an effort to restrict the growth of the public sector without impairing growth in the private sector. The variable formula method avoids the arbitrary limits on economic growth imposed by the fixed number method. As earlier noted, California now has gone to the variable formula method as a way to limit government expenditures.

Analysis of State Limitations

When budgets and expenditures are severely limited and the quantity of services needs to be reduced, a logical question is whether the cuts should be selective or across the board. Apart from mandated programs, cutting across the board by a uniform fraction implies that all programs are equally beneficial.

This is a proposition economists and public policy analysts find highly implausible. They would argue, instead, for selective or differential cuts of programs offering the lowest marginal benefits.

Political realities, however, make it difficult for elected public officials to be selective about reductions in spending. Every program has its constituency and its organized body of supporters. Budget-cutting is never easy, but a plan to cut all departments or programs about the same fraction (on the principle of sharing the misery) is likely to meet the least resistance.

Most state taxation and spending limitations have been initiated by legislatures. Apparently legislatures sensed the public's growing discontent with government and placed limits on the growth of government spending, while maintaining some flexibility in the government's ability to respond to changes in demand for services.

One might think that the states that have adopted tax and spending limitations are the high tax states. One way to measure a state's relative tax level (or tax burden) is to compute the ratio of state general fund expenditures to state personal income. Table 1 presents the results of that computation for 49 of the 50 states.

Table 1 is divided into two groups or categories—states that have adopted tax and expenditure limitations and states that had not adopted tax and expenditure limitations prior to 1988. Alaska was excluded because of its unique fluctuations in revenues and expenditures.

The most striking conclusion that can be drawn from Table 1 is found in a comparison between the states with limits and the states without tax or spending limitations. The ratio of state tax revenues to state personal income for the group of states with limits overall is not noticeably different from the ratio for the group without such limits. The same conclusion can be drawn from a comparison of the ratio of state general fund expenditures to state personal income for the two groups (not shown in Table 1).

From these calculations, it appears that the revenue and expenditure patterns of states that are not controlled by taxation and spending limitations are not much different from the patterns of states that are controlled by taxation and spending limitations.

It may be that the overall condition of state economies and the structure of state taxing systems combined with the sensitivity of policy makers to antitax sentiment, have done more to limit state spending than have lids and other restrictions.

Limits on Subdivisions

Most tax and spending limitations have been placed on subdivisions of state government. By January 1989, 43 states had some type of limit on local government expenditures or taxes. (See Table 2.)

Table 2 shows the types of limitations by state and distinguishes between six major types of limits on taxes and expenditures. These types are:

- Tax rate limits
- Revenue limits
- Property tax rollbacks
- Spending limits
- Assessment limits
- Truth-in-taxation (or full disclosure) provisions.

(See box on page 5 for more detailed definitions of the various types of limitations on taxes and expenditures.)

Table 2 yields several general conclusions and observations.

1. Forty-three states have limits on local government expenditures or taxes;

2. A limit on property tax rates is the most common type of limitation. Thirty states have this type of limit;

3. Limitation on property tax revenue is the next most common form of restriction;

4. Only three states—Arizona, California, and New Jersey—have some form of limit on spending increases;

Table 2
Restrictions on Local Government Tax and Expenditure Powers

State	No Limits	Property Tax Rate Limits	Property Tax Revenue Limits	Revenue Rollbacks	General Revenue Limits 1984	Expenditure Limits	Limits on Assessment	Full Disclosure
Alabama		X						
Alaska		X	X					
Arizona			X			X	X	
Arkansas		X		X				
California		X				X	X	
Colorado			X					X
Connecticut	X							
Delaware				X				C
Florida		X		X				X
Georgia	X							
Hawaii								X
Idaho		X	X					
Illinois		X	X					X
Indiana			X					
Iowa		X					X	X
Kansas				X				
Kentucky		X		X				X
Louisiana		X		X				
Maine	X							
Maryland							X	X
Massachusetts		X	X					
Michigan		X		X				X
Minnesota		X			X			X
Mississippi		X	X					
Missouri		X		X				
Montana		X		X				M
Nebraska		X						
Nevada			X		X			
New Hampshire	X							
New Jersey			C			M		
New Mexico		X	X				X	
New York		X					X*	
North Carolina		X						
North Dakota		X	X					
Ohio		X		X				
Oklahoma		X						
Oregon			X					
Pennsylvania		X						
Rhode Island			M					X
South Dakota		X						
South Carolina	X							
Tennessee								X
Vermont	X							
Virginia				X				X
Texas		X		X				X
Utah		X						X
Washington		X	X					
West Virginia		X						
Wisconsin	X							
Wyoming		X						
U.S. Total	7	30	15	12	2	3	6	16

C: counties only; M: municipalities only; *selected cities only. Source: NCSL survey of legislative fiscal officers, municipal leagues, and associations of counties, August 1988

5. Only two states have a general revenue limit;

6. Six states limit assessment increases;

7. Sixteen states have full disclosure or truth-in-taxation provisions in effect;

8. Most states limit local governments by more than one method; and

9. Nebraska already has a property tax limitation measure similar to what other states in the Plains region have adopted, which is a mill levy on municipalities.

Restrictiveness of Tax and Expenditure Limitations

The purpose of a lid is to restrict state and local government to some publicly acceptable level of spending and taxation. This raises an important question: Are some limits more restrictive than others?

The level of restrictiveness depends on the design features of the spending lid. For evaluation purposes, design features can be classified under four headings: 1. the permissible level of growth of taxes or spending, 2. exemptions, 3. override provisions, and 4. the degree of detail incorporated in the limit.

A variable formula method is less restrictive than a fixed number method. In the fixed number method, a 2 percent lid is more restrictive than a 5 percent lid. The proposed 2 percent lid for Nebraska is a fixed number method of controlling government budgets and expenditures.

Public expenditures regarded as relatively uncontrollable frequently are exempted from a limit. Debt service, for example, typically is exempt from the limit. If debt service is not exempt, the ability of the local government to pay its bonds may be impaired, which may not only interfere with a government's ability to finance itself, but also reduce its bond rating and increase interest expenses.

In some cases, certain social service costs are exempt because they result from mandates imposed by higher levels of government; examples are special education programs, unemployment, and welfare benefits. It appears that the language used in the proposed 2 percent (fixed number) lid for Nebraska does not permit exemptions of the kind indicated here.

Another factor influencing the restrictiveness of a limit is the provision for overriding it. At one extreme, no override is permitted. Many states that have enacted spending limitations allow a majority of local voters to override a limit. The proposed 2 percent lid for Nebraska does permit overrides—an override by four-fifths of the members of the state legislature for state budgets and majority voter approval for an override at special elections for subdivisions.

One other feature of overrides is the number of years that the limit may be suspended by a single override referendum. The most restrictive practice is to require annual renewal of the override. The proposed lid for Nebraska requires annual renewal of the override.

The degree of detail incorporated into a limitation also is important in determining how restrictive it is. One objective measure of the degree of detail is the number of local units of government that are affected by the spending limitation. As noted earlier, one legal interpretation of the proposed 2 percent lid for Nebraska is that the lid covers state government and all subdivisions of government. As indicated earlier, there are over 3,000 subdivisions of government in Nebraska.

Summary

On the basis of the four restrictions discussed in the previous section and the language contained in the proposed 2 percent lid amendment, it is reasonable to state that Nebraskans will be voting this November on an extremely restrictive lid to control government spending.

Professor Bruce Johnson of UNL's Department of Agricultural Economics noted in the March 1990 issue of *Business in Nebraska* that ". . . we must approach tax issues and fiscal policy with a new mindset. Rather than reactive or crisis management, we need to assume a proactive style of decision making. Proactive decision making means seeing the longer run, not just the short run; it means understanding the total system, not just a specific component; it means considering broader societal interest, not just individual interest." Professor Johnson's advice is worthy of much consideration.

The second part of this series on the 2 percent lid will look at the longer-run effects of a 2 percent (fixed number) lid by applying the lid to representative budgets of several governmental subdivisions. Specifically, the lid will be applied to a budget of a typical local school district, an average county budget, and municipal budget from a representative Nebraska town to analyze how the lid may affect local services.

Common Forms of Tax and Expenditure Limits

A **tax rate limit** (or a **millage limit**) restricts the millage rate or nominal tax rate; that is, the amount of property tax that may be imposed per dollar of assessed valuation.

A **revenue limit** restricts the percentage increase of revenue from one year to the next. It usually applies to property tax revenue, but it also may apply to other kinds of revenue.

A **revenue rollback limit** goes into effect only when property is revalued. It requires that the tax rate be reduced, usually to prevent any increase in revenues.

A **spending limit** or **expenditure limit** sets a maximum on the percentage increase in local spending from one year to the next.

An **assessment limit** restricts the percentage increase of the assessed valuation of existing property. Assessment limits may not actually restrict local revenue.

A **truth-in-taxation limit** (or **full disclosure**) requires special notification to taxpayers of proposed tax increases through advertisements and/or the mail as well as special public hearings.

Nursing Homes in Nebraska

James Creigh
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Nebraskans likely will face a severe shortage of nursing home services in the near future. This shortage may be acute for many rural areas of the state. This looming shortage reflects both supply and demand conditions within the industry.

Supply of nursing home services soon will be reduced due to new federal Medicaid regulations mandated by the Omnibus Budget Reconciliation Act (OBRA) of 1987. This legislation replaced a two tier nursing standard for nursing homes receiving Medicaid funds with a single standard nursing staff requirement. These regulations go into effect October 1, 1990.

Under current legislation, nursing homes receiving Medicaid funds may be certified as either skilled nursing facilities (SNF) or intermediate care facilities (ICF). SNF homes must have at least one nurse on duty at all times. Nurses may be either registered nurses (RNs) or licensed practical nurses (LPNs). ICF homes, however, are required only to have nurses on duty eight hours per day, five days per week. ICF homes are required to have nursing care available 24 hours per day, with such care usually provided by nurses aides.

Under the 1987 OBRA regulations, the ICF classification will be eliminated. ICF homes will have to upgrade their services to the higher SNF standard to be eligible for Medicaid funds. Nursing homes receive such a high proportion of their funding from Medicaid that the option to refuse Medicaid funds is not realistic.

The OBRA regulations will create a huge demand for nurses. Many homes, however, may not be able to fill the new nursing positions. Those homes that cannot fill nursing positions face losing their Medicaid eligibility.

Nebraska nursing homes already are facing staff shortages. It is estimated that Nebraska nursing homes currently cannot fill 450 nursing positions (both RN and LPN spots). These 450 positions represent 20 percent of the total nursing positions in Nebraska nursing homes.

One estimate predicts that full implementation of the OBRA requirements would create 400 additional nursing positions in Nebraska nursing homes, bringing the total shortfall to about 40 percent.

A large increase in demand for nursing home services will create an additional 1000 positions over the next 30 years.

Nursing homes face difficulties in filling nursing positions not encountered by either hospitals or doctors' offices. Hospitals and doctors' offices are able to fill nursing positions more easily than nursing homes because hospital and office work often is seen as more challenging, glamorous, or economically rewarding. Nursing homes often are able to recruit from only the small pool of nurses who are dedicated to nursing home care or who have not accepted jobs in hospitals or doctors' offices.

Rural homes face an additional obstacle in recruiting nurses. Rural homes generally cannot match the salaries offered in urban centers. Also, younger nurses often prefer to live in more urban areas. Thus, rural nursing homes face two hurdles in recruiting nurses—that of being a nursing home (rather than a hospital or doctor's office) and that of a rural location.

While supply of nursing home services is about to contract, demand for these services will continue to increase. The most rapidly growing age groups are the old. In the longer run, the baby boom generation will begin to demand significant quantities of nursing home care in about 20 years.

Historical statistics indicate that of Nebraska males between the ages of 65 and 74, 1.3 percent require nursing home care; between the ages of 75 and 84, 5.67 percent require nursing home services; and of those over age 85, 22 percent require nursing home services. For Nebraska females between the ages of 65 and 74, 1.9 percent require nursing home care; between the ages of 75 and 84, 8.54 percent require nursing home care; and for those over age 85, 31.8 percent need nursing home care.

The total population of nursing homes is predicted to rise from 15,316 in 1985 to 23,000 in 2020, as shown in Table 1. Thus, we face a 50 percent increase in nursing home demand at a time when supply likely will shrink.

Table 1
Projected Nursing Home Residents in Nebraska

	65 and Older	85 and older
1985	15,316	8,003
1990	16,237	8,672
1995	17,327	9,635
2000	18,420	10,571
2005	19,421	11,468
2010	20,493	12,502
2015	21,608	13,147
2020	23,029	13,308
% Growth 1985/2020	50.4%	66.3%

Source: Stephen R. Frederick and Kay L. Anderson, *Projections and Analysis of Nebraska's Elderly Population Through 2020* (Nebraska Department of Health)

The two trends of shrinking supply of nursing home services and increasing demand for these services implies that costs for these services will increase. Direct nursing costs account for over half of nursing home expenses. The severe nursing shortage, especially among nursing homes, and the resulting rise in nursing costs will impact overall nursing home costs significantly.

If the new nursing regulations mandated by the OBRA are enacted as written, nursing home consolidations may be necessary to control costs, especially in rural areas. Nursing homes have a threshold efficiency size generally larger than most rural towns could support. For instance, one nurse may be able to care for ten residents as efficiently as for two residents. Rural nursing homes may be able to reach this threshold size by combining with other nursing homes.

Consolidations, however, will mean that nursing home residents may be forced to live farther away from family and friends than is currently common. Future nursing home residents may not be able to reside in their home towns, but may be forced to live several miles away by the restrictions imposed by nursing home economics.

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Review and Outlook

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National Outlook

Recession Woes

One of the current major concerns is that we may talk ourselves into a recession. Some analysts are saying that we are already in a recession, although evidence of a recession simply does not exist. The economy is definitely weak, but we cannot say with certainty that a recession has started.

The likelihood of a recession has increased markedly from pre-Iraqi invasion times. We now face the possibility of a shock-induced recession—one where the curtailment of oil supplies will lead to a collapse of consumer and business confidence, a retrenchment of consumer expenditures, and a reduction both in business inventories and in plant and equipment investment.

The current situation is parallel to that of the early 1970s. In October 1973, some Arab members of OPEC embargoed oil deliveries to the United States. A recession began in November 1973, one month after the start of embargo. The U.S. economy continued to decrease until March 1975, when it reached its trough. Thus, it is reasonable for us to be concerned about the immediate impact of a partial cutoff of oil supplies.

Other parallels to the oil supply difficulties of the 1970s exist. In both cases, the economy had experienced a prolonged expansion. In the early 1970s, the economy had been in an expansion associated primarily with the continuation of the Vietnam conflict. The current expansion is the longest peacetime period of growth in our nation's history.

There are substantial differences, however, between the economy in 1973 and the economy in 1990. In the earlier period, inflation was rampant and a system of price controls had been implemented. We were in the midst of Phase IV of price controls when the Arab oil embargo hit.

The economy had reached an overheated state, and it took little to precipitate a major recession. The major difference today is the degree to which the economy is overheated. The distortional price pressures of 1973 are absent today. We should be concerned over a curtailment of oil supply and its impact on our nation's price system, however.

Fortunately, discussion of relief from other members of OPEC has begun. They can supply the shortfall of oil production lost from Iraq and Kuwait. At this writing, wholesale energy prices already have receded from their extreme highs.

Another difference is the degree of oil dependency. In the early 1970s, we relied on imports for approximately one-third of our petroleum product needs. Today that dependence is approaching 50 percent.

The primary question is the policy reaction evoked by the Middle East conflict. Fiscal policy will be oriented toward the military response to the Iraqis. To a lesser extent, there will be some concern over the issues regarding the federal deficit. I strongly suspect that the moves to cure the deficit problem will be ignored—only Band-Aid legislation will be enacted. Military spending is likely to increase in the near term. On the whole, we will find fiscal policy stimulating.

We have seen a short-term reaction to ease interest rates. The Federal Reserve dropped the federal funds rate from 8.25 percent to 8 percent. But the Fed is in a quandary. Part of their problem concerns the likely duration of the Middle East conflict.

If the conflict continues, there is a danger that the Fed will try to correct conflict-related price pressures single-handedly. If the Federal Reserve goes all out to fight forthcoming inflation, then we likely will have a recession. It is our hope that the Federal Reserve will steer a more middling

Table 1
National Indicators

	Annual	Quarterly (SAAR)				
	1988	1989	1989:III	1989:IV	1990:I	1990:II
Real GNP (% change)	4.5	2.5	1.7	0.3	1.7	1.2
Real Consumption (% change)	3.6	1.9	4.6	-0.8	1.1	0.3
Housing Starts (millions)	1.5	1.4	1.3	1.3	1.5	1.2
Auto Sales (millions)	10.6	9.9	10.8	8.7	9.7	9.5
Interest Rate (90 day T-bill)	6.7	8.1	7.8	7.6	7.8	7.8
Unemployment Rate (%)	5.5	5.3	5.3	5.3	5.3	5.3
Money Supply, M2 (% change)	5.1	3.7	6.9	7.0	6.0	2.9
Industrial Production Index (1987=100)	105.4	108.1	108.1	108.1	108.3	109.4

NOTE: SAAR—seasonally adjusted at annual rates
Source: Bureau of Economic Analysis

course and continue to practice gradualism in its monetary policy.

The key to how we will emerge from the Middle East crisis is its duration. There is no way to predict how long this crisis will continue. The indefinite duration also raises several issues that have no answers, unfortunately. Will the OPEC offset to the shortfall of Iraqi and Kuwaiti oil production be effective? Will it continue?

It looks like such assistance will occur. As we have mentioned, wholesale prices already have decreased. Retail prices at the pump have not yet responded. The major oil companies will have a severe public relations problem if they fail to respond promptly to a reduction in wholesale prices by lowering retail pump prices. After all, pump prices were quick to increase when wholesale prices rose. The public expects pump prices to fall when wholesale prices drop.

We also should look at the possibility of a recession not occurring. The economy is on a knife's edge, with extremely slow rates of growth.

Avoiding a recession requires that just the right economic policy be followed. The real impact of war efforts and attendant production responses may offset oil shock impacts. Avoiding a recession is all a matter of luck. The odds of no recession occurring are fairly low.

Economic forecasters are revising their outlooks. There is a disagreement on whether a recession looms in the near term, but there is a strong agreement that we are facing periods of slow growth. Some analysts observe that there is little difference between small positive growth and small negative growth. The economic result is nearly the same.

In a recent *Wall Street Journal* poll, forecasters revised their outlook for growth in the second half of this year to a miserly 0.3 percent. Growth in the first half of next year similarly was dropped to 1.0 percent. Those figures are both substantially lower than the pre-Middle East crisis numbers.

In other economic news, evidence of the weak economy continues. July retail sales increased only 0.1 percent. That figure is somewhat deceiving, as June sales were up a full 1.1 percent. Thus, July figures simply may be leveling.

Second quarter GNP figures were revised to an increase of 1.2 percent. Auto and truck production plans have been revised downward for the third quarter, and August auto sales are off from a year ago level. The unemployment rate crept up to 5.5 percent in July.

Some pre-oil crisis price figures were released for July. The Producer Price Index fell one tenth of a percent. The Consumer Price Index showed an increase of 0.4 percent. On a year-to-date basis, consumer prices have increased 5.8 percent. Neither of those figures incorporate any of the rapid increases in oil prices that we saw in August. The August Producer Price Index and Consumer Price Index will both show rapid increases.

Housing starts plummeted once again, reaching a total of 1.14 million in July. July totals were at the lowest level since September 1982.

Industrial production was dead flat in July versus June. On a year-to-date basis, July increased 1.9 percent. The Industrial Production Index is leveling after fairly reasonable increases in both May and June.

Perhaps one of the most promising pieces of information was an increase in personal income of 0.6 percent in July. The pre-Iraqi invasion figures for the economy nearly all show an economy in a fairly delicate state.

Nebraska Outlook

The USDA recently released forecasts for the nation's net farm income. The outlook for crop income is fairly positive at this time. Nebraska likely will share in good crop numbers in this year's harvests, although some parts of our state have had production difficulties. For example, moisture levels in western Nebraska are not back to normal. The USDA showed a

Table II
Employment in Nebraska

	Revised June 1990	Preliminary July 1990	July % Change vs. Year Ago
Place of Work			
Nonfarm	731,725	719,076	2.3
Manufacturing	96,875	95,777	0.8
Durables	47,121	46,235	0.8
Nondurables	49,754	49,542	2.4
Mining	1,705	1,757	3.8
Construction	26,455	26,968	4.3
TCU*	47,035	46,990	2.4
Trade	186,821	186,824	1.4
Wholesale	55,601	55,755	3.1
Retail	131,220	131,069	0.7
FIRE**	48,644	48,473	-0.9
Services	174,451	172,848	3.7
Government	149,739	139,439	3.7
Place of Residence			
Civilian Labor Force	858,463	863,173	5.4
Unemployment Rate	2.0%	2.2%	

* Transportation, Communication, and Utilities
**Finance, Insurance, and Real Estate

Source: Nebraska Department of Labor

Table III
Price Indices

	July 1990	% Change vs. Year Ago	YTD % Change vs. Year Ago
Consumer Price Index - U* (1982-84 = 100)			
All Items	130.4	4.8	4.9
Commodities	121.6	3.9	4.4
Services	139.9	5.6	5.3
Producer Price Index (1982 = 100)			
Finished Goods	118.0	3.5	4.1
Intermediate Materials	113.0	0.4	0.9
Crude Materials	101.2	-2.4	0.7
Ag Index of Prices Received (1977 = 100)			
Nebraska	163	4.5	3.4
Crops	129	-5.8	-7.3
Livestock	185	10.1	8.7
United States	152	4.1	2.8
Crops	130	-3.0	-4.7
Livestock	173	10.2	9.0

U* = All urban consumers
Source: U.S. Bureau of Labor Statistics, Nebraska Department of Agriculture

small upward revision in fuel cost for 1990. In essence, the time for big fuel expenses has passed.

USDA's outlook for 1990 U.S. net farm income remains fairly optimistic, between $47 to $52 billion. Net farm income is the difference between receipts and outlays for the current year's production plus government payments.

The outlook for next year is not as good. The increase in oil prices, if sustained, will result in substantial increases in the cost of production. Not only will the cost of fuels rise, but many of the petrochemicals used in farming also will increase in price.

At the same time, there is no reason to forecast an increase in revenue from crops and livestock that will cover these increases in costs. This implies that farmers are in for a squeeze in net farm income next year. If Middle East problems continue, then next year's outlook for our nation's and Nebraska's farmers is less than optimistic.

Nebraska's construction continues to run counter to the U.S. trends. According to F.W. Dodge, after June showed a decrease from last year, July's value of contracts increased 52 percent ahead of a year ago. On a year-to-date basis, total building square footage has increased 25 percent. Although the nation's housing starts fell in July, Nebraska housing starts showed an increase of 25 percent on a year-to-date basis in July.

Retail sales were up 4.5 percent in May versus a year ago. That increase contrasts sharply with the small increase of 3.2 percent in June. Because of strong gains earlier in the year, year-to-date retail sales are 6.2 percent ahead of year ago levels.

Unemployment rates in Nebraska showed a slight increase to 2.2 percent in July. The number of jobs jumped 2.3 percent. A major decrease in state and local government employment occurred between June and July. The state and local government jobs reflect a loss of the gubernatorial reelection workers who were included in the June data.

There has been some discussion to the effect that Nebraska may be an economy that is recession proof. Unfortunately, that sentiment is largely just talk. In the previous national recession, the economy began to slow in early 1981 and did not recover until the end of 1982. Similarly, Nebraska

Table IV
City Business Indicators
May 1990 Percent Change from Year Ago

The State and Its Trading Centers	Employment (1)	Building Activity (2)
NEBRASKA	5.4	10.2
Alliance	4.1	-2.5
Beatrice	4.5	45.2
Bellevue	3.5	-33.2
Blair	3.5	-50.7
Broken Bow	4.0	824.1
Chadron	9.5	-72.5
Columbus	7.3	24.0
Fairbury	1.8	534.3
Falls City	8.8	13.5
Fremont	6.7	130.0
Grand Island	5.4	29.0
Hastings	6.4	1.5
Holdrege	3.9	19.5
Kearney	6.2	318.4
Lexington	9.6	-45.4
Lincoln	4.9	4.9
McCook	3.0	71.3
Nebraska City	-0.2	262.6
Norfolk	9.0	-5.2
North Platte	10.4	55.1
Ogallala	9.5	56.1
Omaha	3.5	5.5
Scottsbluff/Gering	3.6	-5.0
Seward	6.8	25.4
Sidney	6.6	-64.6
South Sioux City	2.3	-36.1
York	10.9	11.9

(1)As a proxy for city employment, total employment (labor force basis) for the county in which a city is located is used

(2)Building activity is the value of building permits issued as a spread over an appropriate time period of construction. The U.S. Department of Commerce Composite Cost Index is used to adjust construction activity for price changes

Sources: Nebraska Department of Labor and reports from private and public agencies

Figure I
City Business Index
May 1990 Percent Change from Year Ago

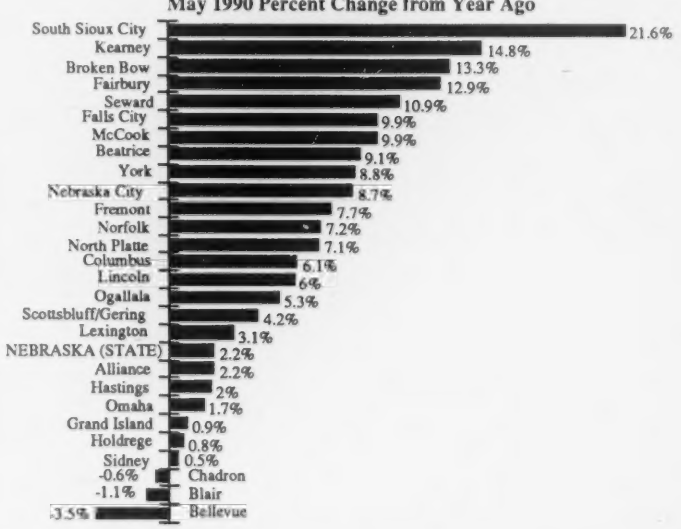
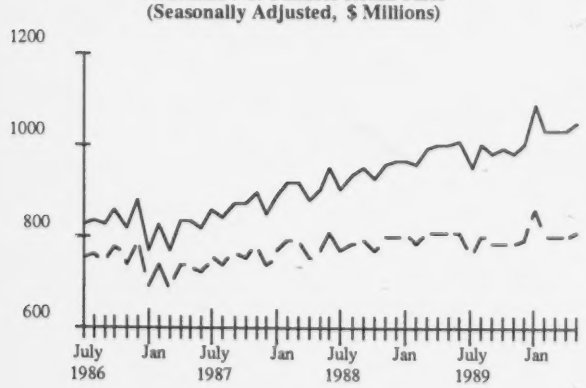


Table V
Net Taxable Retail Sales of Nebraska Regions and Cities

Region Number and City (1)	City Sales (2) May 1990 (000s)	City Sales (2) % Change vs. Year Ago	Region Sales (2) May 1990 (000s)	Region Sales (2) % Change vs. Year Ago	Region Sales (2) YTD % Change vs. Year Ago
NEBRASKA	$890,412	5.8	$1,037,699	4.5	6.2
1 Omaha	301,160	3.1	382,227	1.8	4.8
Bellevue	12,234	3.8	*	*	*
Blair	4,901	5.2	*	*	*
2 Lincoln	123,491	11.6	145,556	9.2	6.5
3 South Sioux City	7,034	56.2	9,159	38.1	30.8
4 Nebraska City	3,937	9.3	18,952	7.9	8.2
6 Fremont	16,734	5.0	30,985	5.0	7.6
West Point	3,128	21.3	*	*	*
7 Falls City	2,395	15.7	9,548	2.9	5.5
8 Seward	4,672	19.0	15,792	8.9	8.2
9 York	7,309	11.2	16,727	10.1	2.8
10 Columbus	15,932	7.6	28,367	4.2	6.6
11 Norfolk	20,202	11.4	36,566	7.8	6.1
Wayne	3,068	6.9	*	*	*
12 Grand Island	32,694	-3.0	47,499	-2.2	3.7
13 Hastings	15,557	1.3	25,395	-0.5	1.9
14 Beatrice	8,427	15.6	19,542	19.2	11.3
Fairbury	3,060	10.8	*	*	*
15 Kearney	20,828	15.3	29,567	12.4	4.7
16 Lexington	6,144	7.4	17,239	8.8	2.7
17 Holdrege	4,843	-0.8	8,746	-0.6	6.3
18 North Platte	15,830	4.1	20,293	2.5	7.6
19 Ogallala	6,038	1.0	12,867	-0.2	3.9
20 McCook	8,865	17.2	12,951	16.2	4.8
21 Sidney	4,044	9.4	8,093	2.9	2.2
Kimball	1,741	6.5	*	*	*
22 Scottsbluff/Gering	19,230	9.8	27,037	6.4	5.6
23 Alliance	5,558	4.6	14,233	1.3	2.2
Chadron	2,733	6.7	*	*	*
24 O'Neill	4,995	22.3	15,750	13.6	8.9
Valentine	2,733	13.3	*	*	*
25 Hartington	1,678	20.6	8,662	9.4	3.7
26 Broken Bow	3,645	5.1	12,395	8.2	2.6

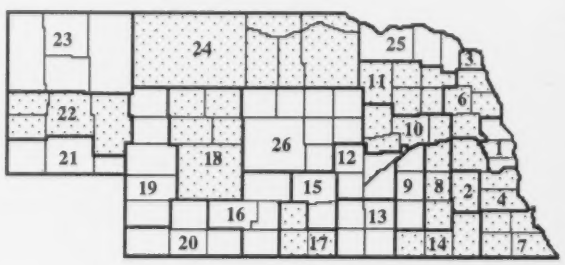
(1) See region map
(2) Sales on which sales taxes are collected by retailers located in the state. Region totals include motor vehicle sales
* Within an already designated region
Compiled from data provided by the Nebraska Department of Revenue

Figure II
Nebraska Net Taxable Retail Sales
(Seasonally Adjusted, $ Millions)



(1) The Consumer Price Index (1982-84 = 100) is used to deflate current dollars into constant dollars. Solid line indicates current dollars; broken line indicates constant dollars

Figure III
Region Sales Pattern
YTD as Percent Change from Year Ago



Shaded areas are those with sales gains above the state average. See Table V for corresponding regions and cities

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saw decreases in its gross state product at that time, but showed no signs of recovery even in 1983. 1983 was a bad year for Nebraska agriculture. Thus, the downturn in agriculture at that time reinforced an already weakened economy.

Given the outlook for next year's net farm income for the nation and the likelihood that Nebraska will share in those difficulties, we cannot expect much improvement, if any, in Nebraska's net farm income. Nebraska's nonfarm economy tends to follow the patterns of the U.S. economy.

Because we expect substantially weakened growth at the national level in 1991, we can be less than optimistic for the Nebraska economy. The rapid rates of growth in jobs that we have seen in our state for the last year and a half likely will decrease as the impacts of the national recession work their way through to the Nebraska economy.

State of the State Conference to be in December this Year

The third annual State of the State Conference series will be held at three locations in December this year, announced Bureau director Charles Lamphear. "This will enable business leaders to have economic information about the state and their regions before the close of the year," he said.

This year's theme will be "Nebraska's Opportunity in Expanding Global Markets." Programs will vary at each location to reflect issues affecting the specific local economies as well as the overall theme.

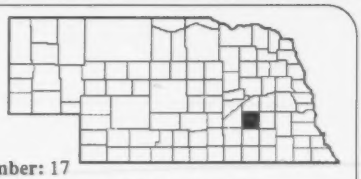
Following are the dates and locations for the conferences.

December 4	Columbus, New World Inn;
December 6	Scottsbluff, Elks Lodge; and
December 12	Lincoln, Nebraska Center for Continuing Education.

Reservations are now are being accepted for the State of the State workshops. For more information, call or write the Bureau of Business Research, University of Nebraska-Lincoln, Room 200 College of Business Administration, Lincoln, Nebraska 68588-0406, 402/472-2334.

County of the Month

York



York--County Seat

License plate prefix number: 17
Size of county: 577 square miles, ranks 50th in the state
Population: 14,900 (estimated) in 1988, a change of +0.4 percent from 1980
Median age: 31.2 years in York County, 29.7 years in Nebraska in 1980
Per capita personal income: $15,300 in 1988, ranks 22nd in the state
Net taxable retail sales ($000): $104,298 in 1989, a change of +4.4 percent from 1988; $42,928 during January-May 1990, a change of +2.8 percent from the same period one year ago
Number of business and service establishments: 498 in 1988; 61.2 percent had less than five employees
Unemployment rate: 2.6 percent in York County, 3.1 percent in Nebraska for 1989
Nonfarm employment (1989):

	State	York County
Wage & salary workers	705,672	6,360
	(percent of total)	
Manufacturing	13.4%	13.9%
Construction and Mining	3.6	2.9
TCU	6.5	5.9
Retail Trade	18.5	19.6
Wholesale Trade	7.6	15.7
FIRE	6.8	4.4
Services	23.7	20.8
Government	19.9	16.8
Total	100.0%	100.0%

Agriculture:
Number of farms: 899 in 1987, 911 in 1982
Average farm size: 388 acres in 1987
Market value of farm products sold: $109.1 million in 1987 ($121,370 average per farm)

Sources: U.S. Bureau of the Census, U.S. Bureau of Economic Analysis, Nebraska Department of Labor, Nebraska Department of Revenue

Merlin W. Erickson

Business in Nebraska

PREPARED BY BUREAU OF BUSINESS RESEARCH
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September 1990, Volume 46 No. 552

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